

BEFORE THE TENNESSEE REGULATORY AUTHORITY

NASHVILLE, TENNESSEE

May 6, 2004

IN RE:

**COMPLAINT OF US LEC OF TENNESSEE, INC
AGAINST ELECTRIC POWER BOARD OF
CHATTANOOGA**

)
)
) **DOCKET NO.**
) **02-00562**
)

INITIAL ORDER OF HEARING OFFICER

This matter is before the Hearing Officer following an evidentiary hearing held on February 25, 2004 and March 16, 2004 to resolve the one remaining issue raised by US LEC of Tennessee, Inc. ("US LEC") in its Complaint against Electric Power Board of Chattanooga ("EPB" or the "Company").

BACKGROUND

EPB was certificated by the Tennessee Regulatory Authority ("TRA") as a facilities-based telecommunications services provider in the State of Tennessee in Docket No. 97-07488 on May 10, 1999. The interveners in this certification proceeding were American Communications Services, Inc.; AT&T of the South Central States, Inc.; BellSouth Telecommunications, Inc.; the Consumer Advocate and Protection Division of the Attorney General's Office; MCI Telecommunications Corporation; NEXTLINK of Tennessee, LLC; the Tennessee Cable Telecommunications Association ("TCTA"); and the Tennessee Power Company.

Because EPB is a municipal electric company authorized to provide telecommunications services pursuant to Tenn. Code Ann. § 7-52-401, the Company is prohibited from providing subsidies for its telecommunications services.¹ In order to “provide assurance that subsidization does not occur and to properly allocate cost,” EPB and the TCTA agreed to a set of proposed conditions (“Proposed Conditions”) to govern EPB’s interactions with its telecommunications division. Section Seven of these Proposed Conditions² is a Code of Conduct, addressing discriminatory behavior and including a paragraph labeled “Joint Marketing of Regulated and Nonregulated Services,” which provides as follows:

The electric system and the telecommunications division of the Electric Power Board of Chattanooga may jointly offer their respective products and services to customers provided that the customer is informed (a) of the separate identities of each and (b) that the products and services of the electric utility system are distinct and separately priced from the offerings of the telephone division and customer may select one without the other.

These Proposed Conditions were adopted by reference into the *Order Approving Application for Certificate of Public Convenience and Necessity* (“CCN Order”).

On May 15, 2002, US LEC filed a Complaint against EPB alleging discriminatory and anti-competitive practices in violation of state law and the orders of the TRA.³ Following issuance of the *Order on the Motion for Summary Judgment of the Electric Power Board of Chattanooga* by the Hearing Officer on June 26, 2003, three issues remained unresolved.⁴ Two of these issues were settled informally by the Parties prior to the evidentiary hearing.⁵ The one issue remaining is whether EPB’s marketing and advertising activities have violated the Code of Conduct and/or the anti-subsidization provisions of Tenn. Code Ann. § 7-52-402.

¹ Tenn. Code Ann. § 7-52-402

² The Proposed Conditions were attached in full as “Exhibit 2” to US LEC’s Complaint

³ *Complaint of US LEC of Tennessee, Inc. Against Electric Power Board of Chattanooga*, p. 1 (May 15, 2002).

⁴ *See Order Establishing Procedural Schedule*, p. 1-2 (October 9, 2003)

⁵ *See Letter from Henry Walker* (December 3, 2003).

POSITION OF US LEC

US LEC's basic premise is that the EPB brand, *i.e.*, its name and reputation, has a value, that EPB's telecommunications division ("EPB Telecom") benefits from its association with this brand, and that such benefit without appropriate compensation amounts to an illegal subsidy and creates an unfair competitive advantage for EPB Telecom.⁶ US LEC objects to what it deems the leveraging of the EPB brand by EPB Telecom in its marketing and advertising activities or, put another way, the blurring of the distinction between "EPB Power and EPB Telecom."⁷ In support of its position, US LEC provided numerous examples of what it considers joint marketing and advertising activities of electric and telecommunications services without, in the opinion of US LEC, clear differentiation between the two providers.⁸ The objectionable activities include referring to EPB's telecommunications division as only "EPB," instructing the sales force to push the EPB brand, and making statements like the following: "We have been around for seventy years;" "EPB is becoming more than a power company;" "EPB is a good company to build upon;" "Everything we've learned over the years about keeping the lights on . . . has been put to good use in our telecommunications delivery. So you can be sure your phone service will be as reliable as your power service;" and

But whether you have electric, telecommunications or other services from EPB, one thing will never change – the way we've always put the needs of our customers first. It's a way of doing business that's served us well for more than six decades – a philosophy which is, indeed, more current than ever.

To remedy this allegedly objectionable conduct, US LEC proposes that EPB Telecom be required to pay for the use of the EPB brand or, alternatively, to change its name to something that does not indicate its relationship with EPB. Since it may be difficult to place a value on the

⁶ See *Post Hearing Brief of US LEC of Tennessee, Inc* , pp 1, 7 (April 7, 2004)

⁷ *Id* at 2, 3

⁸ *Id* at 3-7

benefit received from using the EPB brand, it is the latter remedy that US LEC recommends. US LEC contends that a name change nearly five years post certification is not unfair since name changes are common in the industry and should impose no undue hardship on EPB since the Company has invested much more in the EPB brand than in the EPB Telecom brand.⁹ Consistent with this recommendation, US LEC also asks that the Code of Conduct be clarified to prevent EPB Telecom from further capitalizing on its relationship with EPB in any of its marketing or advertising activities.¹⁰

POSITION OF EPB

In its defense, EPB claims that US LEC has provided no legal basis for the contention that the mere use of the EPB brand amounts to a subsidy and that US LEC has failed to show that EPB has illegally subsidized its telecommunications operations through improper cost shifting or has in any way violated the Code of Conduct.¹¹ Accordingly, EPB maintains that there is no legal or factual basis for prohibiting the use of the name EPB by its telecommunications division.

In as much as EPB itself was certificated to provide telecommunications services in the State of Tennessee pursuant to the authority of Tenn. Code Ann. § 7-52-401, EPB maintains that its telecommunications division is now providing services simply as a division of the Company, not as a separate legal entity.¹² Therefore, EPB suggests that the use of EPB Telecom is an accurate representation of the Company's telecommunications certification and that, because EPB and EPB Telecom are part of the same legal entity, the telecommunications division is not prohibited from using the company name to provide telecommunications services. EPB offered

⁹ *Id* at 9-10

¹⁰ *Id* at 15-16

¹¹ *See Post-Hearing Brief of EPB*, p. 14 (April 6, 2004).

¹² *Id* at 4

several examples of electric company affiliates or subsidiaries using the name of the electric company to provide telecommunications services. EPB contends that, if a company can use the name of a separate but affiliated electric company to provide telecommunications services, then EPB's telecommunications division may appropriately be called EPB Telecom.¹³

Further, while agreeing that the EPB brand does have value in the marketplace, EPB suggests that its value to EPB Telecom is limited and has not in any significant way eliminated the need to separately market and advertise EPB's telecommunications services. Rather than just creating a benefit, EPB Telecom suggests that any lack of differentiation between EPB and EPB Telecom has actually obscured in the mind of consumers the availability of the Company's telecommunications services. Therefore, EPB Telecom has made much effort to differentiate itself from EPB and, to this end, has attempted to create and sell a separate EPB Telecom brand, not just the EPB brand.¹⁴

Finally, EPB argues that the issues of cross-subsidization and the use of the EPB brand by EPB Telecom were addressed by the TRA at the time of its certification. According to EPB, it has been no secret that electric and telecommunications services would be provided by a single legal entity and that EPB's experience providing electric services would be used to provide telecommunications services.¹⁵ Because US LEC did not intervene in the certification proceeding and did not object at that time to the use of the EPB name by the telecommunications division, EPB asserts that the issue has already been decided and US LEC has now lost its right to object.¹⁶

¹³ *Id* at 2-3

¹⁴ *Id* at 3-4.

¹⁵ *Id* at 4-5.

¹⁶ *Id* at 21-23

FINDINGS AND CONCLUSIONS

As an initial matter, it is apparent from the evidence presented that US LEC is without the necessary standing to challenge the propriety of EPB's advertising and marketing activities. In order to demonstrate standing, US LEC was required to show that it has suffered a distinct and palpable injury, which was caused by the allegedly objectionable activities and can be remedied by a favorable decision.¹⁷ Although US LEC has alleged anti-competitive conduct by EPB, it has introduced no evidence of any resulting harm to US LEC or any other telecommunications services provider. Without this demonstration of harm, US LEC would not be entitled to the requested relief, regardless of the legal merits of its allegations.

However, the TRA's role as a regulator is limited by neither the standing of a complaining party nor the equitable doctrine of laches. While under either doctrine US LEC may not be in a position to pursue its complaint against EPB, the TRA remains authorized and obligated to determine whether the allegedly objectionable conduct of EPB is indeed in violation of the law or the Company's Code of Conduct.¹⁸

Tenn. Code Ann. § 7-52-402

Municipalities operating an electric power plant in the State of Tennessee are authorized to also provide telecommunications services within the perimeters outlined by Tenn. Code Ann. § 7-52-401 *et seq.* One very important limitation on this authority is the prohibition of Tenn. Code Ann. § 7-52-402 against subsidizing these services. This prohibition was recognized by the TRA in the *CCN Order* but not precisely defined by either the *CCN Order* or the governing statutes. However, the *CCN Order* did adopt by reference the Proposed Conditions governing

¹⁷ *Marceaux v Sundquist*, 107 S W 3d 527, 531-32 (Tenn. Ct App 2003) (citing *Lujan v Defenders of Wildlife*, 504 U S 555, 560, 112 S Ct 2130, 2136, 119 L Ed.2d 351 (1992))

¹⁸ See Tenn Code Ann § 65-4-104.

EPB's interactions with EPB Telecom. According to Section Two of these Proposed Conditions, "[t]he rules and regulations outlined in the following sections are intended to discourage the EPB from subsidizing the costs of the newly created telecommunications division by shifting costs to the activities of the electric system." Thus, a subsidy, as defined by the Proposed Conditions and adopted by the *CCN Order*, would be the shifting of costs from EPB Telecom to EPB. In order to prevent this cost shifting, the Proposed Conditions include accounting principles and procedures designed to allocate costs between EPB and its telecommunications division.

The Federal Communications Commission ("FCC") has taken a similar approach to this issue, finding a subsidy, or cross-subsidization, to exist "when the reasonable costs associated with a service are not covered by the revenues generated by that service, but are instead covered by revenues generated by one or more other services."¹⁹ Like the Proposed Conditions, the FCC mandates the use of a cost allocation methodology to apportion costs between regulated and unregulated activities in order to avoid illegal cross-subsidization.²⁰

Based upon this guidance, the existence of an illegal subsidy should be determined by focusing on the allocation of incurred costs between EPB and EPB Telecom.²¹ Specifically, all costs associated with providing telecommunications services should be allocated only to EPB Telecom, and the telecommunications services should not in any way be subsidized by the revenues generated by EPB's electric services. To prove the existence of an illegal subsidy, it would be necessary to prove that EPB Telecom is not covering its own costs and that revenues from EPB's electric services are being used to provide telecommunications services.

¹⁹ See *In the Matter of Implementation of the Telecommunications Act of 1996 Accounting Safeguards Under the Telecommunications Act of 1996*, FCC 96-490 (*Report and Order*) 12 F C C R 2993, ¶ 1, n 4 (December 24, 1996)

²⁰ *Id.* at ¶ 57

²¹ This definition of cross-subsidization has been adopted by the courts in several contexts. See *California v Federal Communications Commission*, 39 F.3d 919, 926 (9th Cir. 1994) (telecommunications), *Natural Gas Clearinghouse v Federal Energy Regulatory Comm'n*, 108 F.3d 397, 346 (D.C. Cir. 1997) (energy), and *Shalala v Guernsey Mem'l Hosp.*, 514 U.S. 87, 98, 115 S.Ct. 1232, 1238, 131 L.Ed.2d 106 (1995) (healthcare)

For this reason, US LEC's argument falls short. There is no evidence in the record that EPB has incurred any costs related to providing telecommunications services that were not allocated solely to EPB Telecom according to statutory requirements and the guidelines of the Proposed Conditions. Nor is there any evidence that costs related to providing telecommunications services have been paid by EPB's electric revenues. Absent any such showing, there is no legal basis for the finding of an illegal subsidy.

Although there were certainly costs associated with the development of the EPB brand, these costs were largely incurred long before the creation of EPB Telecom, and there is no documented cost to EPB solely from the association of this brand with EPB Telecom. While it may be true that the EPB brand has an intrinsic value in the marketplace and that EPB Telecom has benefited from its association with this brand, there is no support for the premise that the use of a valuable asset without compensation amounts to a subsidy as contemplated by the law.

Code of Conduct

Consistent with the general safeguards against illegal subsidization, the Code of Conduct, specifically the subsection labeled "Joint Marketing of Regulated and Nonregulated Services" (the "Subsection"), allows EPB to jointly offer its electric and telecommunications services so long as the products are not bundled together at a single price and the separate identity of each provider is disclosed to customers. US LEC has alleged no inappropriate bundling of services but has alleged that the distinction between EPB and its telecommunications division has been blurred by the aforementioned advertising and marketing activities of EPB Telecom in violation of the Code of Conduct.

Because the requirements of the Subsection are only implicated if electric and telecommunications services are jointly offered, the precise meaning or intent of this provision is

important to its application. While the language of the Code of Code itself may not be entirely clear on the meaning of “jointly offer” or “joint marketing,” reference to federal law is helpful in this regard. In the context of joint marketing of local and long distance services, a Regional Bell Operating Company (“RBOC”) and its affiliate may not engage in the following activities prior to the RBOC’s 271 certification: (1) market both services through a single transaction, which includes the use of the same sales agent to market both products to the same customer during a single communication;²² (2) offer both services as a bundled package under an integrated pricing schedule;²³ (3) if both services are advertised together, state or imply that the services can be purchased in a bundle through a single transaction.²⁴

Thus, consistent with the language of the Subsection, federal law is, essentially, prohibiting the bundling of these services at a single price and efforts to sell the services in a single transaction. The advertising and marketing examples provided by US LEC do not fall within these definitional perimeters. Although these advertising and marketing activities certainly promote EPB Telecom as a provider of telecommunications services, and allude to EPB for this purpose, no particular product or service is being offered for sale to customers. Moreover, there are no specific telecommunications services offered to customers in conjunction with electric services notwithstanding the association of EPB Telecom with EPB.

Accordingly, the Code of Conduct does not apply to these advertising and marketing activities and has not been violated. It may be true that these advertising and marketing activities have, to some extent, blurred the distinction between EPB and EPB Telecom, but US LEC has provided no evidence of a situation in which EPB Telecom was obligated to make this

²² 47 C F R §53 101(b)(1)

²³ 47 C F R §53 101(b)(2)

²⁴ 47 C F R §53 101(c)

distinction. Absent an actual joint offer of electric and telecommunications services, as defined above, EPB is not required to clearly distinguish the separate identities of the providers.

Moreover, it makes little rational sense to require this distinction in the manner suggested by US LEC. No where else in the Code of Conduct or in the Proposed Conditions is EPB required to disclose the separate identities of EPB and EPB Telecom. From the full context of the Code of Conduct, it is evident that this distinction is not required for any reason but to prevent EPB from inappropriately leveraging its position as a monopoly provider of electric services into the telecommunications market by linking together the purchase of electric and telecommunications services. There is no other apparent justification for requiring the disclosure of separate identities except as pertaining to EPB Telecom's obligation to make separately available its telecommunications services.

Further, in most respects, a distinction between EPB and EPB Telecom would not be consistent with reality. Although EPB is providing telecommunications services through a separate division, there is legally only one entity. Thus, except as directly relating to actual electric products and services, the history and reputation of EPB is also the history and reputation of EPB Telecom. It was this history and reputation, including the Company's sophisticated technical systems for providing electric services, that were relied upon, at least in part, for EPB's certification as a provider of telecommunications services.²⁵ Accordingly, even though EPB Telecom has existed for only a few years, it is not unreasonable for this division to draw upon EPB's seventy-year history and established reputation for reliability and customer service.

Finally, this artificial distinction requested by US LEC is also not required under state law. While state law does prohibit anti-competitive conduct and the subsidizing of

²⁵ See *Order Approving Application for Certificate of Public Convenience and Necessity*, p. 8 (May 10, 1999)

telecommunications services as discussed above, state law does not require a municipal electric system to offer telecommunications services through a separate division or even under a different name.²⁶ Evidently, these measures were not deemed necessary in order to prevent the prohibited activities. Accordingly, as long as EPB remains in compliance with its present obligations, there is no apparent need to impose on the Company a requirement not currently contemplated in the law or in its Code of Conduct.

IT IS THEREFORE ORDERED THAT:

1. The marketing and advertising activities of EPB Telecom have not violated Tenn. Code Ann. § 7-52-402 or the Code of Conduct included within the Proposed Conditions and adopted by the TRA on May 10, 1999 in Docket No. 97-07488.
2. All relief requested by US LEC in this Docket related to the alleged violations of Tenn. Code Ann. § 7-52-402 and the Code of Conduct is hereby denied.
3. Any party aggrieved by the Hearing Officer's decision in this matter may file a petition for reconsideration within fifteen days from the date of this Order.
4. Any party aggrieved by the TRA's final decision in this matter has the right of judicial review by filing a petition for review in the Tennessee Court of Appeals, Middle Section, within sixty days from the date of the final order.



Kim Beals, Counsel
as Hearing Officer

²⁶ In contrast, the prohibition against subsidizing cable or internet services provided by a municipal electric system must be achieved through the creation and maintenance of a separate division Tenn Code Ann § 7-52-603